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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

RODERICK J. MACKENZIE, MALCOLM L. MACKENZIE and DAVID H. MACKENZIE, INC.,

Petitioners,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONERS

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In its Brief in Opposition, the Government seeks to block review in this Court by masking a clear conflict among the circuits and by persistently misinterpreting an important statutory tax relief provision.

1. The Government first urges denial of the petition for certiorari on the initial question presented by petitioners—whether uncertainty in the substantive tax law can be ignored in a federal criminal tax prosecution (Pet. O, 2)[1]—by asserting

1. References in this Reply Brief are indicated as follows:

   1. To the numbered pages of the Petition (Pet. ____);

   2. To the numbered pages of the Appendix to the Petition (____a);

   3. To the numbered pages of the Brief for the United States in Opposition (Br. Opp. ____).

that the decision below conflicts with no other opinions of any court of appeals or of this Court (Br. Opp. 5). This claim is in blatant disregard of: (a) the conflict between the rule applied by the Second Circuit in this and one earlier case and that adopted by at least three other circuits, and (b) the plurality opinion and holding of this Court in *James v. United States*, 366 U.S. 213 (1961).

A. As the Government obliquely recognizes, the court below has proclaimed in this case—relying upon its previous decision in *United States v. Ingredient Technology Corporation*, 698 F.2d 88, 96-97 (2d. Cir.), *cert. denied*, 462 U.S. 1131 (1983), that uncertainty in the tax laws may not be considered unless the defendant "genuinely thought what he was doing was lawful" (16a). What the Government ignores is that the Fourth, Fifth and Ninth Circuits, in direct conflict with the Second Circuit's holdings in *Ingredient Technology* and in this case and the Sixth Circuit's holding in *United States v. Curtis*, 782 F.2d 593, 599-600 (6th Cir. 1986), have held that the impact of uncertain tax obligations in a criminal tax prosecution does *not* depend on whether the taxpayer was personally misled by such uncertainty. *United States v. Mallas*, 762 F.2d 361 (4th Cir. 1985); *United States v. Dahlstrom*, 713 F.2d 1423, 1427-28 (9th Cir. 1983), *cert. denied*, 466 U.S. 980 (1984); *United States v. Garber*, 607 F.2d 92 (5th Cir. 1979) (en banc); *United States v. Critzer*, 498 F.2d 1160 (4th Cir. 1974). One of these courts has expressly held that uncertainty or confusion in the substantive tax law "does not depend on whether the defendant actually knew of" such uncertainty. *United States v. Garber*, 607 F.2d at 98, citing *United States v. Critzer*, 498 F.2d 1160.[2]

That there is in fact a conflict among the circuits, contrary to the Government's assertion, is recognized by commentators:

> Some circuit courts have held that objective uncertainty in the tax laws has little bearing on the subjective question of whether the defendant willfully violated those laws, ab-

2. The Sixth Circuit in *Curtis* expressly "decline[d] to follow" and rejected the reasoning of *Garber*. 782 F.2d at 599.

> sent a factual link such as the defendant's reliance on a particular judicial or administrative ruling or advice from informed counsel. Other circuit courts have held that objective uncertainty can absolve the defendant, as a matter of law, regardless of subjective factors such as the defendant's intent and knowledge.

Note, *Uncertainty in the Law: An Uncertain Defense in Criminal Tax Prosecutions*, 39 Tax Lawyer 387 (1986).

> Since the *James* decision, various circuits have issued conflicting decisions regarding the effect of uncertainty of tax law on willfulness from both substantive and procedural perspectives.

Elliott, *CA-9 In Dahlstrom Analyzes Effect of Tax Law Uncertainty on Criminal Prosecutions*, 62 J. Tax'n 150 (1985).As these authors make clear, *Critzer, Garber* and *Dahlstrom* conflict with *Ingredient Technology*. The Government's position to the contrary may stem from its erroneous assertion that petitioners "contend (Pet. 11-17) that they lacked the requisite intent to violate the tax laws" (Br. Opp. 5). In fact, petitioners seek review of the following question: whether, *regardless of the taxpayers' subjective intent*, the substantive law relating to the classification of construction workers for tax withholding purposes was, during the tax years in question, so confusing, conflicting and uncertain that as a matter of law the claimed tax duty was not sufficiently "knowable" so as to sustain a criminal conviction for a willful violation of that duty. *United States v. Mallas*, 762 F.2d at 363.

The Government attempts to evade the clear conflict among the circuits by claiming there is an "absence of any uncertainty in the law as applied to petitioners' workers" (Br. Opp. 7). This ignores that the underlying tax obligation in this case—the classification of workers for withholding tax purposes—has had a virtually unprecedented history of ambiguity, confusion and inconsistency expressly acknowledged by Congress in its enactment of § 530 of the Revenue Act of 1978 (46a).

This significant and growing conflict, which the Government seeks to disguise, merits resolution by this Court.

B. The Government also mischaracterizes this Court's leading case on uncertainty in criminal tax prosecutions, *James v. United States*, 266 U.S. 213. The Government argues that in *James* this Court "did not hold that uncertainty in the law negates willfulness as a matter of law" (Br. Opp. 7). However, that is precisely what the *James* majority did conclude; reversing defendant's conviction "outright", ordering a dismissal of the indictment and expressly rejecting Justice Harlan's suggestion that James be re-tried to determine whether or not he had in fact been aware of and acted in reliance on the uncertain state of the substantive tax law. 366 U.S. at 222, 244, 248.

As one commentator has noted:

> [I]n *James*, a taxpayer was convicted of tax evasion for failing to report embezzled funds. The Supreme Court squarely overruled [*Commissioner v.*] *Wilcox* [327 U.S. 404 (1946)] and held that embezzled funds were taxable. Nonetheless, the Supreme Court reversed the defendant's conviction, holding that the uncertainty of taxability of embezzled funds created by *Wilcox negated willfulness as a matter of law, regardless of the defendant's actual reliance on Wilcox.*

Elliott, *CA-9 In Dahlstrom Analyzes Effect of Tax Law Uncertainty* at 150 (emphasis added).

2. The Government's assertion that the court of appeals correctly decided the second quesiton presented here—whether § 530 of the Revenue Act of 1978 has any application to a criminal tax prosecution (Pet. O, 2)—flies in the face of the plain language of the statute, of explicit legislative admonitions that its "reasonable basis" relief provision is to be "construed liberally in favor of taxpayers," H.R. Rep. 95-1748, 95th Cong., 2d Sess. at 5 (1978) (35a), and this Court's requirement that an "employer's obligation to withhold [must] be precise

and not speculative." *Central Illinois Public Service Company v. United States*, 435 U.S. 21, 31 (1978).

The Government continues in its unwillingness to acknowledge Congress' explicit adoption of the House of Representatives' objective "reasonable basis" standard in the final version of § 530 rather than the Senate's state-of-mind "good faith" standard. Section 530(a)(2) sets forth what the subsection title states is "*one method* of satisfying the requirements of paragraph (1)" through "reasonable reliance" on any of three specific precedents (emphasis added). Contrary to the Government's suggestion (Br. Opp. 10 n.3 and 11), these specific precedents of § 530(a)(2) are not the *exclusive* bases for the safe-haven relief. Section 530 (a)(1) provides a residual safe-haven for a taxpayer who has had *any* "reasonable basis" for his treatment of a worker as a non-employee. Both the Report of the House Ways and Means Committee (31a) and the Joint Committee on Taxation (82a) confirm this statutory structure by stating that the three statutory safe-havens of § 530(a)(2) are merely examples and not meant to exhaust the circumstances under which a "reasonable basis" could properly be found:

> The three statutory methods for fulfilling the requirement that a taxpayer had a reasonable basis for the treatment of an individual as other than an employee *are not the exclusive ways of meeting the Act's reasonable basis requirement*. A taxpayer who can demonstrate a reasonable basis for the treatment of an individual as other than an employee in some other manner also is entitled to termination of employment tax liabilities.

H.R. Rep. 95-1748 at 5 and Staff of the Joint Committee on Taxation, 95th Cong., 2d Sess., *General Explanation of the Revenue Act of 1978* at 302-303 (Joint Committee Print 1979) (36-37a, 87a) (emphasis added).

What the Government characterizes as "the substantial identity between the standards used in the two versions" of the bill

(Br. Opp. 11) and its reliance on the superseded Senate report (Br. Opp. 10) are unsupportable. Although the "good faith" concept of the discarded Senate bill would still be satisfied by the three express factors set forth in the statute as enacted, such factors are but "*one method*" of meeting the non-exclusive "reasonable basis" test. Thus, the description of "good faith" contained in the discarded Senate Report and relied on here by the Government is a dead letter, having no bearing on § 530 as enacted in its final form. Even though the changes in the Senate version were later described by the House-Senate Conference as having been made for "technical reasons," H.R. Conf. Rep. 95-1800, 95th Cong., 2d Sess. 271, *reprinted in* 1978 U.S. Code Cong. & Ad. News 7198, 7266, it does not follow, as the Government suggests (Br. Opp. 11), that the changes were insignificant.[3] In enacting the far-reaching relief provisions of § 530 and potentially affecting great numbers of employers subject to federal withholding obligations, Congress unambigiously rejected the "good faith" measurement and instead adopted a test which now defines the duty to withhold *solely* by reference to an objective standard of conduct. Thus employers facing criminal charges stemming from a misclassification of workers for tax purposes should be afforded what petitioners here were completely denied: an opportunity for the jury to determine whether—whatever their subjective intent—their classification had any "reasonable basis" within the meaning of § 530(a) of the Revenue Act of 1978, as enacted.

The Government's fall back position that petitioners' conduct could not in any event be deemed "objectively reasonable" (Br. Opp. 11 n.5) underscores petitioners' claim that the

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3. The entire discussion of § 530 in the Conference Report on the 1978 Revenue Act legislation is contained in less than one page of a 120 page report; its complete description in the General Explanation of the Revenue Act of 1978, prepared by the Staff of the Joint Committee on Taxation, comprises only four and one-half pages of a 468 page report. Given its context, the conferees' characterization of the change in § 530 as "technical" is surely meaningless. In light of the massive scope of the Revenue Act of 1978, it would not have been unreasonable for the conferees to have labeled § 530 in its entirety as "technical."

jury and not the Government should have made the determination of whether or not they had a duty to withhold from the payments at issue. Once it is recognized, as it has been here (27a), that the requirements of § 530 were otherwise met, a jury could have readily found that, under the standards of § 530, the taxpayers were under no initial duty to withhold taxes from the payments in dispute. The Government's conclusory description of petitioners' conduct as unreasonable emphasizes that there was an issue that the jury should have been allowed to consider. If the jury had not agreed with the Government's contentions, it might have voted an acquittal notwithstanding petitioners' subjective intent.

Left unreviewed by this Court, the judgment of the court below that § 530 can be properly ignored in this tax prosecution will: (1) seriously undermine a host of civil penalty provisions contained in the Internal Revenue Code,[4] and (2) constitute approval for denying the jury the opportunity to consider the Government's obligation to prove in withholding cases what it must prove in every tax prosecution: "that there was a tax owed to it by the defendant." *Elwert v. United States*, 231 F.2d 928, 932 (9th Cir. 1956).

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4. *See* Petition at 24 n.14.

CONCLUSION

For these reasons, then, this Court should—and petitioners request that it does—issue its writ of certiorari to review the judgment of the court below.

Respectfully submitted,

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